

## Asset-Backed Securities and CLOs

# No Bond Left Behind



**Peter Van Gelderen**  
Managing Director

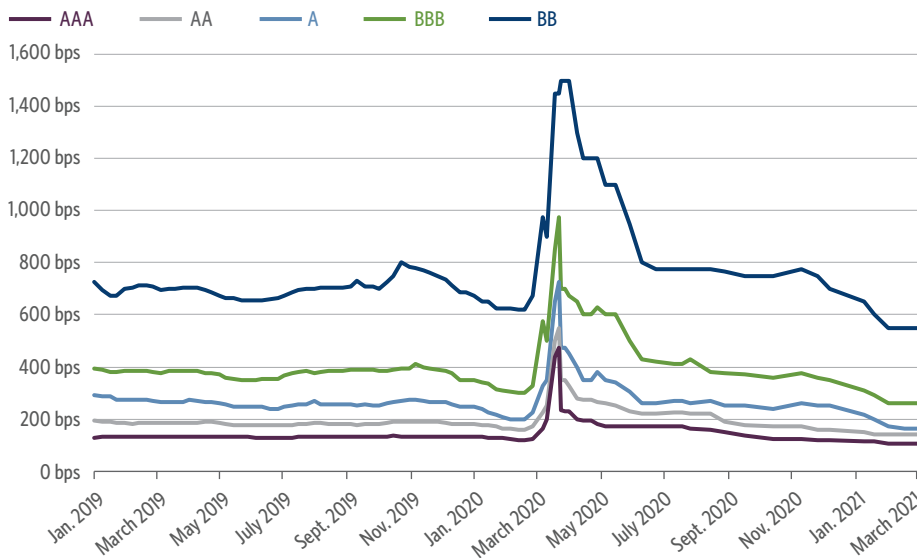
The Fed's QE "vaccine" has left investors flush with cash but few yielding investment alternatives.

The recovery in credit markets that occurred following March did not pass over the CLO market, where prices have fully recovered from the COVID-19 correction. Senior and subordinated CLO tranches both participated in the rally and are currently trading at the tightest spreads in the last two years (see chart, top right). Similarly, leveraged loans, the collateral for CLOs, rallied back to pre-COVID levels and largely avoided the wave of COVID-related defaults many had feared. As a result, rating agencies, which had downgraded a significant number of CLO tranches by mid-2020, have reversed course and now are reviewing many CLO tranches for upgrades. With this constructive backdrop, CLO new issuance surged in the fourth quarter of 2020 and should continue to exhibit considerable strength in 2021 (see chart, bottom right). Further, the rally in CLO spreads and leveraged loan prices has created a favorable environment for CLO refinancing and reset activity. We estimate the combined activity in both new issue and refi/reset will rival levels last observed in 2018. However, investor demand will likely meet the heavy primary market supply in step and keep CLO spreads tight and range-bound for the balance of 2021.

Most ABS subsectors have also fully recovered from the COVID-19 correction. Prices for bonds across all subsectors rose sharply as both interest rates and credit spreads collapsed in the second half of 2020. Many ABS securities now trade at large premium prices that may limit further price upside, though yield advantages versus similarly rated corporates still exist. ABS borrowers and Wall Street underwriters have capitalized on the strong investor demand by both improving execution levels and reintroducing transactions that had failed to launch in 2020. In the fourth quarter of 2020 and the start of 2021, new issue subscription levels have routinely exceeded 3x-5x on offered securities. As a result, borrowers have been able to substantially improve bond pricing execution. In fact, demand has been so strong at the start of 2021 that two separate transactions in rail and real estate that had failed to find enough investor interest in 2020 were successfully reintroduced in January 2021 at spreads that were tighter than the original failed levels. There is simply too much cash in investor coffers and too few high yielding alternatives.

Our current investment focus balances our prioritization of strong, creditworthy investments with a constructive view on macroeconomic conditions. We have recently found compelling risk-adjusted profiles in financial ABS, aircraft sale-leaseback transactions, and subordinated CLO debt investments.

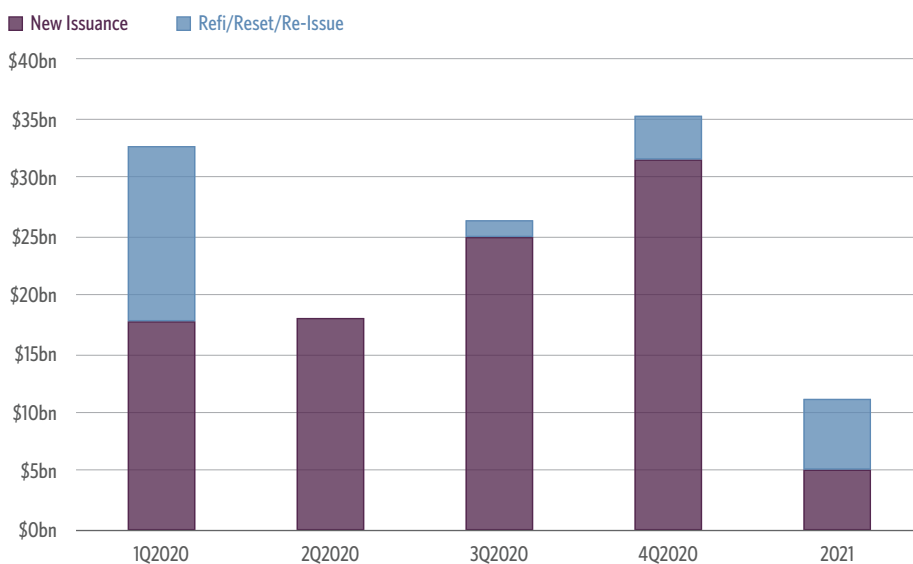
### Investment-Grade CLO Spreads Have Tightened From Recent Peaks



Source: Guggenheim Investments, J.P. Morgan. Data as of 3.5.2021.

Senior and subordinated CLO tranches both participated in the rally and are currently trading at the tightest spreads in the last two years. Similarly, leveraged loans, the collateral for CLOs, rallied back to pre-COVID levels and largely avoided the wave of COVID-related defaults many had feared.

### Q4 CLO Issuance Rebound Looks Set to Continue in Q1



Source: Guggenheim Investments, J.P. Morgan. Data as of 1.22.2021

CLO new issuance surged in the third and fourth quarters as investor demand and pricing spreads recovered from COVID trough levels. In 2021, we expect a continued uptick in primary market activity, especially refinance/reset activity.

Investing involves risk. In general, the value of fixed-income securities fall when interest rates rise. High-yield securities present more liquidity and credit risk than investment grade bonds and may be subject to greater volatility. Asset-backed securities, including mortgage-backed securities, may have structures that make their reaction to interest rates and other factors difficult to predict, making their prices volatile and they are subject to liquidity risk. Investments in floating rate senior secured syndicated bank loans and other floating rate securities involve special types of risks, including credit risk, interest rate risk, liquidity risk and prepayment risk. Guggenheim Investments represents the following affiliated investment management businesses of Guggenheim Partners, LLC: Guggenheim Partners Investment Management, LLC, Security Investors, LLC, Guggenheim Funds Investment Advisors, LLC, Guggenheim Funds Distributors, LLC, GS GAMMA Advisors, LLC, Guggenheim Partners Europe Limited and Guggenheim Partners India Management. ©2021, Guggenheim Partners, LLC. No part of this article may be reproduced in any form, or referred to in any other publication, without express written permission of Guggenheim Partners, LLC.